The Growing GM Crisis Requires That National Policy Change Course

by Richard Freeman

General Motors Vice chairman Bob Lutz's alarming speculation on March 24 that GM may shut down one or more of its "brand" production divisions—starting with Pontiac or Buick—underscores the reality that General Motors' credit rating may soon be reduced to junk, which would be accompanied shortly thereafter, by its filing for bankruptcy. Each new plunge of GM's credit rating, occurring in full public view in recent weeks, has sent shock waves through the world's bond and stock markets, threatening the world financial system.

On March 16, Standard and Poor's rating service lowered GM's credit rating outlook to one step above junk. In another blow on March 22, GE Capital announced it would be withdrawing a $2 billion financing facility to GM. Investors sold off the automaker's bonds so heavily, and their value fell so steeply, that GM must now pay a wider interest rate premium (above that of U.S. Treasury securities) than most Third World countries.

Within hours of General Motors' financial crisis deepening, Wall Street financiers, led by Morgan Stanley and Credit Suisse investment banks, mounted a media campaign for a plan that is as insane as it is unworkable: that GM must be carved up, permanently cut its production, slash its workforce, reduce worker benefits, etc.—the knee-jerk reaction of banking networks to any financial crisis.

The auto sector's technologically advanced machine tool capacity, and its skilled labor, would be critical to Lyndon LaRouche's Super-TVA plan for reconstructing the U.S. economy. LaRouche commented March 24, that in its present form, GM is not going to make it, but, "GM is a critical piece of the manufacturing capability of the United States; without such capability, the nation can't make it." It is also a significant piece in the international economy, with Opal in Germany, Saab in Sweden, etc. "The physical side of the operation can not be allowed to go under," LaRouche asserted. "We must come up with a survival plan—to preserve the industrial side, rather than the GMAC financial operation."

The preserved capability could be used to construct a magnetically levitated rail system, and so on.

S&P Downgrade

The events of March 16 and March 22 show not only GM's severe problems, but also how ill-equipped the bankrupt world financial system is, to handle a crisis of the magnitude of General Motors'; with its financing arm, GMAC, it has $301 billion in debt. March 16 served as a powerful shock; March 22 was a violent aftershock.

Even before the markets opened the morning of March 16, GM issued a statement which stated that its 2005 earnings would be as much as 80% below its prior forecast of January 2005, and that earnings for the first quarter would be negative, compared with its prior forecast of breakeven or a small profit. Moreover, the company said that it expected a negative cash flow of $2 billion for all of 2005, when its previous target had been plus $2 billion. However, a credit analyst at the firm Dresdner Kleinwort Wasserstein reported that when special items are considered, GM's negative cash flow could swell to an enormous $4-5 billion for 2005.

The markets waited to see how the credit-rating agencies would respond. GM is currently rated BBB- by Standard and Poor's, one step above junk-bond status. At 2:00 pm that day, S&P held a teleconference call on GM. S&P's lead analyst Scott Sprinzen began with a warning in very strong language: "Between the severity of the guidance revisions that GM has announced this morning, and our directness in recent months in warning about our previously stable outlook [for GM], I expect that there is no one among you who has been surprised that we moved today to revise GM's rating outlook to negative." He added that, "the bad news of this morning outstripped our downside expectations, and the significance for us is . . . what that says, longer term, about how GM is going to fare." Sprinzen's announcement meant that S&P had gone halfway to moving GM to junk bond status. In January, GM had projected that it would earn $4-5 per share, but on the morning of March 16, it had revised that to $1-2 per share. Sprinzen indicated that were it to become clear that GM were on a path to earn $1 per share, that could trigger the junk-bond rating. "We now view [GM's] rating as tenuous. The rating could be lowered at any point if we came to doubt GM was on a trajectory to improving its financial performance," he said.

Once S&P opened the teleconference for questions from analysts at Credit Suisse, JP Morgan, and others, there were three direct questions about GM ending up in bankruptcy court. Though the teleconference was about GM, questions immediately poured in about the financial status of Ford, and the major parts suppliers Visteon and Delphi. In light of the crisis spreading through the entire auto industry, and the

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heavy indebtedness and precarious nature of the junk bond market, *EIR* asked whether this wouldn't hit the entire financial system. Sprinzen answered cautiously, and inaccurately, "this is largely the problem specific to one company [GM]."

Yet, within the first hour of the S&P teleconference call, investors in droves sold off GM bonds. The interest rate that GM is forced to pay on its bonds soared 56 basis points, which is 0.56%, in one day. This is extraordinary: Normally a bond's yield rises or falls by only 1-5 basis points (.01-.05%) per day. GM's stock plunged by 14% to close at $29.01, which pulled the Dow Jones average down by 112 points.

David Cole, director of the Center for Automotive Research, stated that he expected others in the auto industry to have similar problems, "This will not be the only company where you're going to see this kind of comment." He said that the condition of higher raw materials prices were creating "a perfect storm, with a confluence of a large number of factors that are causing severe pressure across the entire [auto] industry."

Investors started dumping many U.S. corporate bond issues by late afternoon. "Some people are buying [U.S.] Treasuries as a place to hide," said E. Craig Coats, co-head of fixed-income securities at Keefe Bruyette & Woods in New York.

At the same time, this intersected the price of petroleum shooting to a record above $56 per barrel, and the announcement that the U.S. current account deficit had risen to a record $666 billion for 2004.

GE Capital Cuts and Runs

The further event that nearly brought GM down started on March 22, with the story reported in that day's *Financial Times,* that GE Capital, the giant financing/speculative arm of General Electric, had withdrawn a $2 billion financing facility to GM.

For a number of years, GE Capital provided "factoring finance" to GM. Under this arrangement, parts-supplier "X" may sell goods to GM, for which GM issues an IOU to company X, promising to pay so much in 45 days. Company X can take this paper immediately to GE Capital. GE Capital will discount it—i.e., pay to Company X less than the full value of the paper, but in cash, immediately. In 2004, GE Capital had informed GM that it would discontinue this factoring operation for GM by the end of 2005; but now it used a contract clause that said that if GM's credit rating were cut to "BBB-, negative,"— as happened on March 16—then GE could opt out of the contract.

Most investors correctly interpreted GE Capital's move as a vote of no confidence in GM, severing ties before GM is officially downgraded to junk—under which condition, GE Capital might possibly not be able to get back the full value of its credit.

Dresdner Kleinwort Wasserstein's analyst Christopher Boulanger said on March 22, "The last thing you want to see is a liquidity provider [GE Capital] pulling its support." Panic ensued, as investors dumped GM bonds. Accordingly, for GM's bonds due in 2033, the interest-rate spread *above* Treasury securities of comparable maturity, shot up to 516 basis points (5.16%). The spread premium that Brazil pays for its foreign bonds is 431 basis points, so the world's largest automaker must now pay a worse premium on its bonds than Brazil and most Third World countries. GM's deterioration triggered a broad jettisoning of U.S. corporate bonds. But the pandemonium was not restricted to the United States: Led by the GM sell-off and related crises, emerging-market bonds fell in Mexico, and emerging-market stocks tumbled in Pakistan, Russia, Argentina, and Turkey.

Trying to stem the chaos, GM and GE Capital released a *joint statement* in the afternoon of March 22, which denied that GE Capital was severing ties to GM. It said that GM and GE Capital would implement an orderly transition, in which GM's finance arm, GMAC, would gradually take over the factoring operation, allowing GE Capital to execute "an orderly exit from the deal." However, no one swallowed this fanciful story; bond prices remained deeply depressed.

Proposals to Cut Production

As the crisis deepened, Wall Street demanded that GM be carved up. Stephen Girsky, chief auto analyst at Morgan Stanley investment bank, said on March 17, "It's one thing to say things are rougher than [GM] expected, but what people want to know is, 'What are they going to do about it?' The company's market share doesn't support its size. They have too many plants, too many workers, too many models, too many dealers, and their employee benefits are too high." Daniel Howes, the auto columnist for the *Detroit News,* regurgitated this theme on March 20, in an article titled, "All Signs Point to Big GM Shakeout." He declared that GM has "too many workers, [and] too many plants;" stated that GM "is studying whether to close more assembly plants in the United States"; and concluded by warning, "Brace yourself for what's likely to be a harrowing ride."

The March 22 *New York Times* reported GM and Ford plan to pressure the UAW to make an agreement with them similar to the one that the United Auto Workers union made with Chrysler, where 35,000 white collar and production workers in Chrysler's workforce, and some retirees, whose medical benefits are covered by Preferred-Provider Organizations (PPOs), agreed to pay first deductibles on healthcare, ranging from $100-1,000. GM has scheduled an April 14 meeting with the UAW, where it is believed this scheme will be brought up. But GM is so over-indebted, that the act of slashing production—which simultaneously slashes the volume of sales—makes payment on the debt even more difficult. This insures that more powerful aftershocks will hit GM and the world financial system. It were better to change course, and adopt the potential offered by LaRouche, to operate GM's priceless capacity full throttle, in a manner that benefits GM and the advancement of the whole economy.